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RECOVERY IN NEW YORK OF INTEREST IN EXCESS OF SIX PER CENT. PAID BY BROKERS ON MONEY BORROWED TO PURCHASE AND CARRY STOCKS ON MARGIN.

The usual transaction incident to the purchase, on margin, of stocks by a broker for his customer is substantially as follows. The customer "A" orders the broker "B" to purchase stocks of the value, for example, of \$100,000. At the time of the order, the customer furnishes a margin of ten per cent. There is no written contract relating to the means by which the purchase is to be carried out.

The broker goes upon the Exchange and contracts to buy the desired stocks. Upon the following day, at 2 o'clock, the selling broker delivers the stock to the purchasing broker, who, in return, delivers a check for the purchase price. The check may be certified when delivered, or the messenger of the selling broker may have it certified. At the time the check is certified, B may or may not have funds in the bank with which to meet it; that is, the bank may certify the check because there are funds to meet it, or because B's credit is good—the bank perhaps holding a demand note for a large amount, given by B as security for such over-certifications.

B takes the stock which he has just purchased for A and places it among his other securities hypothecated with the bank, thereby becoming entitled to a loan on said stock up to such proportion of the stock's value as the bank will advance. The proportion is usually eighty per cent. The money thus obtained may be used by B to make good the account from which the check was drawn to purchase A's stock, or it may be used by him in the purchase of stocks on margin for other customers.

The interest asked by the bank upon the loan by it to B on A's stock may be six per cent. or less, or it may be the call rate of the day. Suppose that the rate is considerably higher than six per cent., and that the broker in rendering his monthly statement to the customer, seeks to charge the customer with the interest paid. Can this be done, and, if so, upon what theory?

The opinion expressed in Dos Passos on Stockbrokers, at page 270, is as follows:

"In respect to the liability of the client to pay interest, it is a well understood rule of stockbrokers to charge him legal interest upon the amount advanced by the broker in the purchase of the stock; it is also the usage of the brokers to charge the client with any extra interest which the broker is compelled to pay for carrying the stocks of the former caused by the stringency of the money market. Both of these usages are reasonable and it does not seem to be difficult to sustain them by authorities."

An examination, however, of the authorities cited in support of the text does not disclose any theory, free from difficulties, upon which to justify such recovery. The only cases cited which are in point are *Smith v. Heath*¹ and *Robinson v. Norris*.²

In the first of these cases it appears from the opinion of the Court that

"The moneys advanced by defendants to carry the stock in question were borrowed by them at the request and for the use of the plaintiff * * * He (the customer) agreed to pay such extra interest and may be said to have borrowed from the defendants the amount necessary for that purpose."

It seems that the original loan for the *purchase* of the stock was made at non-usurious rates. In order to carry the stock, however, it was necessary to raise more money, which money was obtained from third persons, with the customer's assent, and possibly with his written authorization. The rates paid were apparently usurious, but it was intimated that they might be recovered on the theory, as expressed on page 126, that

"all the transactions in reference to the charge and payment of such extra interest were had and conducted, not as between the plaintiff (customer) and defendants (brokers), but between third parties and the defendants as *agents* for the plaintiff."

The only point, however, decided in the case was that the customer could not enjoin the brokers from proceeding upon his note, given to them in part for a valid debt and in part for a debt alleged to be invalid because of usury. The remainder of the opinion was *dictum*.

Giving weight, however, to the *dictum*, it must be noted that the only loans questioned for usury were, first, those obtained to

carry the stock, and, second, those obtained to pay interest on money used to carry the stock. Is this case authority for the proposition that the broker can charge the customer the extra interest paid on money borrowed to purchase the stock? Probably it is, if it be authority at all and if it be conceded that the broker acts merely as agent, the loan being made by the third person to the customer. The agency, however, which was said to have existed in this case, may have resulted from an express written authorization, and the case, therefore, is not a decisive authority in cases where no express authorization exists.

In the second case, *Robinson v. Norris*,³ it was held that where a broker has been authorized by his principal to borrow money in order to carry stocks for him and where in borrowing the money he has been compelled to pay to other persons, as commissions, sums exceeding those allowed by law, he can recover the commissions so paid, unless the principal promptly objects.

This case, as so reported, affirms *Robinson v. Norris*.⁴ It appears from the statement of that case that the broker, at the beginning of the transaction, had informed the customer by letter that it was his custom to charge to his customers, in proportion to their debit balances, such expenses as he might have to incur, by reason of the stringency of the money market, in obtaining the loans for the benefit of his customers. It further appears that the customer had signed an agreement authorizing, to some extent, the payment by the broker of commissions for procuring loans, and, furthermore, that for several months prior to the transactions so questioned, the broker, without objection from the customer, had charged the customer with such commissions.

It is clear, therefore, that in this case, also, certain additional facts were present which are not present in the ordinary transaction as above supposed.

In support of his text, above quoted, Dos Passos also cites *Esterly v. Cole*.⁵ The question in this case was whether certain merchants could charge *any interest at all* on an account for goods sold and delivered. It was held that they could charge interest, because this was the general usage of the trade and because parties having knowledge of the usage were presumed to have contracted with reference to it. The effect of usage will be considered later in this article, but it may be said here that, should it be sought to charge interest in excess of six per cent. upon a loan *from the*

³*Supra.*

⁴(1874) 51 How. Pr. 442.

⁵(1850) 3 N. Y. 503.

broker to the customer (not a call loan),⁶ or to charge commissions exceeding in amount those allowed by Revised Statutes, Pt. I, Ch. 20, Title 19, no usage, however well known, would be sufficient to overthrow the illegality and to entitle the broker to recover such interest or commission.

It is thus apparent, with all respect to the opinion of Mr. Dos Passos, that there are many difficulties in sustaining the recovery by the broker of the charges under consideration.

There are four possible theories upon which the broker may seek to base his right to recover the interest paid by him in excess of six per cent.

First: Upon the theory that the loan is from the bank *to the customer*, and that the customer, in paying the high rate of interest, is paying a *call rate* to the bank, through the broker, as agent.

Second: Upon the theory that the interest in excess of six per cent. is chargeable as a *commission*.

Third: Upon the theory that the advancement is a *call loan from the broker* to the customer.

Fourth: Upon the theory that the interest in excess of six per cent. is an expense necessarily incurred by the broker in order that the *broker* may make the loan to the customer.

Let us consider the possibility of succeeding by the first theory.

It has frequently been held that where a broker has purchased stocks on margin, he holds the stocks as pledgee.⁷ The broker, however, still continues to be, in some respects, an agent also.⁸

The principal difficulty, however, in urging that the broker, as agent for the customer, procures the loan from the bank to the customer is the fact that practically all the decisions in point in this State hold, by implication, that in the ordinary purchase by the broker on margin the loan is made by the broker to the customer.

In *Markham v. Jaudon*,⁹ which is, perhaps, the leading case in this State upon the relationship in question, the Court says, at p. 240:

"The position of the broker is twofold. Upon an order of the customer, he purchases the shares of stocks desired by him. This

⁶See *Robinson v. Norris*, *supra*.

⁷*Content v. Banner* (1906) 184 N. Y. 121; *Rothschild v. Allen* (1904) 90 App. Div. 233.

⁸*Zimmermann v. Heil* (1895) 33 Supp. 391, affd. 156 N. Y. 703; see also *Taussig v. Hart* (1874) 58 N. Y. 425, and *McNeil v. Bank* (1871) 46 N. Y. 325.

⁹(1869) 41 N. Y. 235.

is a clear act of agency. To complete the purchase, he advances from his own funds, for the benefit of the customer, ninety per cent. of the purchase money. Quite as clearly, he does not in this act as an agent, but assumes a new position."

In *Tompkins v. Morton Tr. Co.*,¹⁰ the Court said (at p. 278) as to customers who had bought on margin:

"It must be assumed, therefore, that the securities deposited by H. & F. (brokers) with the Morton Trust Company (which had loaned on security to the brokers) as security for the loans belonged to other customers, and that * * * H. & F. held the stocks and securities as collateral security for advances or loans made by H. & F. to the several defendants named."

There are many other cases in which similar language is used, and in no case, apparently, has the usual advance by the broker upon the purchase price of the stock been regarded as a loan from the bank to the customer, except in those cases where it appeared that the customer had expressly authorized the broker to go and borrow money for him. On the other hand, it has not been squarely held that the loan is not made by the bank to the customer.

It may be contended that usage will take the place of express authorization. This may be true, if the usage be to borrow as agent for the customer from the bank. The practice, however, seems to be for the broker to lend his own funds to the customer. This absolutely precludes the idea that the same money is loaned from the bank to the customer, unless it be urged that the broker, pending the loan from the bank to the customer, has temporarily advanced his own money, and that he repays himself with the money obtained from the bank.¹¹ If this be the case, however, the customer's debt to the broker (*i. e.*, for the advancement on the purchase price) is terminated when the broker repays himself. Such a theory seems too novel to be acceptable.

Furthermore, it must be borne in mind that the market value of the securities pledged by the broker usually exceeds the amount which the bank loans upon them. So, if A's stock is worth \$100,000 and the bank loans \$80,000 upon it—A having put up a margin of \$10,000—there still remains \$10,000 which could in no way be regarded as a loan from the bank to the customer.

Upon the second theory, the excess of interest is regarded as a commission.

¹⁰(1904) 91 App. Div. 274, affd. 181 N. Y. 578.

¹¹See *Smith v. Heath, supra*.

If it be urged, however, that it is a commission to the broker for obtaining the necessary money, the obstacle is the fact that it is made illegal by statute for a broker to charge any such rate for procuring a loan. Revised Statutes, Part I, Ch. 20, Title 19, Section 1, as amended by L., 1895, Ch. 467, provides:

"No person shall, directly or indirectly, take or receive more than fifty cents for * * * procuring the loan or forbearance of one hundred dollars, and in that proportion for a greater or less sum, except loans on real estate security."

Thus, even if it be assumed that the broker does procure the loan from the bank to the customer, his commission for procuring such loan can be the sum only which is allowed by such statute.

The position may be taken that the excess of interest is a commission paid by the broker to the bank and is thus an authorized expenditure in a principal's behalf. It is held in *Robinson v. Norris*¹² that a broker can recover commissions paid to third parties unless the customer promptly objects. The case does not decide, however, whether there can be a recovery if the customer promptly objects. Nor does it appear in that case whether the loan was made to the broker or to the customer. Furthermore, the charge between the bank and the broker is so manifestly interest that to regard it as a commission is scarcely reasonable.

The third theory is the one upon which the advancement by the broker is regarded as a call loan.

Laws of 1882, Ch. 237, Section 1, provides:

"In any case hereafter in which advances of money, repayable on demand, to an amount not less than \$5,000, are made upon * * * certificates of stock * * * pledged as collateral security for such repayment, it shall be lawful to receive or to contract to receive and collect, as compensation for making such advances, any sum to be agreed upon in writing by the parties to such transaction."

It is not easy, however, to establish the proposition that the advancement in question is a call loan, even assuming that the amount involved is over \$5,000.

In the first place, it is essential to a call loan that the money be repayable on demand. I have not been able to find any case in which the meaning of a loan repayable on demand is explained. By analogy, however, to the case of a negotiable instrument payable on demand, it would seem that such a loan must be one which

¹²*Supra*.

is due at any time after it is made. In *McMullen v. Rafferty*¹³ the Court, in holding that the statute of limitations runs against a demand note from its date, uses the following language:

"The word 'demand' is not treated as part of the contract, but is used to show that the debt is due."

The advancement, then, by the broker to his customer is not repayable on demand unless the broker can, at any time, demand that the customer take the stock off his hands by paying the ninety per cent. advanced.

Some cases indicate that the broker must carry the stock for the customer as long as the customer desires, provided that the required margin is kept up.¹⁴ One case holds that agreement must determine whether the stock is to be carried as long as the customer desires (the margin being kept up) or as long as either desires.¹⁵

In the decisions, however, defining the rights of brokers and customers in regard to *short sales*, the rule is as stated in *Hess v. Rau*:¹⁶

"The former (broker) agrees to carry the stock a *reasonable* time, so as to afford the customer an opportunity to realize the expected profits, while the customer on his part is bound to keep his margin good, so as to secure the broker against loss."

The ground of these decisions is set forth in *White v. Smith*:¹⁷

"It is part of the bargain that the broker shall carry the stock for a *reasonable* time, for in no other way can the object of the parties be effected."

While, as stated, the transactions in these cases were short sales, the reasoning seems equally applicable to a purchase on margin. If a broker can, for example, on the day after the purchase, demand what he has advanced in the purchase, and sell the stock, if the advancement be not repaid to him, the purpose of the customer is certainly not, in most cases, carried out, since he desires that the stock be carried long enough for him to take advantage of a change in the market value.

In *Markham v. Jaudon*,¹⁸ however, it is stated that in the ordi-

¹³(1882) 89 N. Y. 454, 459.

¹⁴*Gillett v. Whiting* (1890) 120 N. Y. 402; *Rogers v. Wiley* (1892) 131 N. Y. 527, 530 (short sale).

¹⁵*Price v. Gover* (1874) 40 Md. 102. ¹⁶(1884) 95 N. Y. 359, 362.

¹⁷(1874) 54 N. Y. 522. ¹⁸*Supra*, at p. 239.

nary purchase on margin, the broker agrees to carry the stocks (the margin being kept good) "until notice is given by either party that the transaction must be closed"; furthermore, that the customer agrees to take the shares purchased on his order "whenever required by the broker."

In *Stenton v. Jerome*,¹⁹ with reference to a purchase on margin, the Court said:

"Under this agreement the defendants were not obligated to carry the stocks indefinitely. Whenever they desired to close the transaction in reference to any stocks, it was their duty to tender the certificates therefor to the plaintiff and demand payment for them; then, if within a reasonable time she did not take and pay for the stocks, they had the right to sell" on notice, etc.

If the two cases last cited state the law correctly, the broker may demand the repayment of his advancement at any time, so that the transaction might be regarded as a call loan if the other necessary elements were present. However, these decisions are in conflict with the reasoning of the short-sale decisions above cited, which seem to be logically correct.

It may be noted also that no demand is necessary in order to make due a *note* payable on demand,²⁰ while all the cases agree that a *loan* to the customer would not be due until demand had been made for its repayment.²¹

Furthermore, in the usual case of a purchase on margin, no writing exists except, possibly, the order. Interest in excess of six per cent. cannot be collected by the lender unless the parties have agreed in writing to such rate of interest.²²

The fourth theory, on which the excess of interest is regarded as an authorized expenditure for the customer's benefit, seems to me to present the fewest difficulties, though it is not fully sustained by authorities.

In *Eaton v. Alger*²³ it was held that the lender could recover, in addition to the legal rate of interest, his travelling expenses in getting the money. The borrower had expressly agreed to pay

¹⁹(1874) 54 N. Y. 480, 483.

²⁰*Wheeler v. Warner* (1871) 47 N. Y. 519; *Cottle v. Bank* (1901) 166 N. Y. 53, 58.

²¹*Stenton v. Jerome, supra.*

²²*Hawley v. Kountze* (1896) 6 App. Div. 217, though even in the absence of writing a loan which has the other elements of a call loan is not usurious.

²³(1864) 2 Abb. App. Dec. 5, 10.

such expenses and it was upon such ground in part that the decision rested. But it was said (as dictum) by the judge who wrote the opinion, as follows :

"Even when the lender, without any special agreement with the borrower, in addition to lawful interest, takes a commission by way of trouble and expense necessarily incurred in and about the business of the loan, the transaction would be supported, provided that such commission was not intended to cover a usurious loan."

The use of the word "commission" in the opinion is rather unhappy, for my purposes, but since the loan in the case was from the same person who procured the money, it is apparent that the charge was not a commission for procuring the loan but rather an expenditure of the lender.

In *Robinson v. Norris*²⁴ it appeared that the brokers, without objection from the customer, had charged him with "Your proportion expenses incurred by us during stringencies on stocks carried for your account."

The charge questioned, however, was not described as an expenditure alone, but as a commission paid by the broker to third persons who procured the money to be loaned to the broker, apparently. It seems to me that it was only necessary to this decision that the broker had made a disbursement authorized by his customer, and that the question whether the broker loaned the money, or whether some third person did so, was immaterial.

It is my contention that usage will take the place of an *express* authorization of *necessary* expenditures, even if the dictum in *Eaton v. Alger* (just cited) be not relied upon. If usage is a sufficient authorization, the following cases are a support for this fourth theory.

In *Thurston v. Cornell*,²⁵ the borrower went to the lender and offered to compensate her for her trouble and expense if she would go to get certain money and lend it to him. The question presented was

"whether the lender of money may lawfully receive from the borrower a reasonable compensation, in excess of interest, for services and expenditures in procuring the money to be loaned, provided the services were performed and the expenditures incurred at the request of the borrower, and upon his express promise to pay therefor. Upon this question there can be no doubt. The compensation thus received is distinct from that agreed to be paid for the loan or

²⁴(1874) 51 How. Pr. 442, 445.

²⁵(1868) 38 N. Y. 281.

forbearance of the money. The latter is interest and cannot lawfully exceed seven per cent.; the former is a stipulated price for work, labor and services done and performed, and for money paid, laid out and expended; as such, it constitutes a distinct demand, which might be recovered in a separate action if not included in the security taken for the principal debt."

The judge, in his opinion, cites *Harger v. McCullough*.²⁶ In this case, also, the creditor had made a journey at the request of the debtor, and upon his promise to pay for the trouble and expense. Bronson, J., said:

"There was no usury. It (the sum charged as expenses) was so much money paid, laid out and expended, for the defendant, upon request, and was as much a debt as the original demand. It might have been recovered, had no arrangement in relation to the original debt been made."

The ground of these decisions is the fact that there are two separate transactions: first, the expenditures by the lender necessary in raising the money to make the loan; second, the loan itself. While the language of these cases is, perhaps, not entirely applicable to the case at bar, the reasoning is—if, as I think, the loan from the bank to the broker, and the loan from the broker to the customer are separate transactions.

*Thurston v. Cornell*²⁷ is cited in *Haughwout v. Garrison*.²⁸ In this case, the creditor agreed to discontinue certain proceedings upon the payment by the debtor of the debt with interest and the expenses incurred. The debtor claimed that the expenses were a part of the consideration for forbearance of money, thus making the agreement usurious. The Court, however, said:

"They had a right to demand indemnity for the expenses incurred by them upon a discontinuance of these proceedings at the request of the debtor, and if the sum demanded was but an indemnity for those expenses, there was no usury."²⁹

All the courts of the country do not favor the doctrine of these cases,³⁰ but such doctrine seems fairly well established in New York. Recovery, however, was refused in *Williams v. Hance*.³¹ In this case, the ground of refusal was, perhaps, the fact that no necessity for the expense incurred was shown. Furthermore, the item agreed to be allowed as expense was in consideration of the forbearance of the principal debt.

²⁶(1846) 2 Denio 119. ²⁷*Supra*. ²⁸(1877) 69 N. Y. 339.

²⁹See also *Wertheimer v. Talcott* (1907) 118 App. Div. 840.

³⁰*Jackson v. May* (1887) 28 Ill. App. 305.

³¹(1839) 7 Paige 581.

Certain restrictions, however, must be borne in mind in urging the fourth theory. Expenses cannot be charged if they are in fact a cover for usury; that is, as stated in *Haughwout v. Garrison*,³² "if the amount claimed and paid was not a part of such expenditures, but was demanded as a cover and device to secure a greater interest than that allowed by law * * *."

The same case, however, further states that

"the affirmative of the issue upon the alleged usury was with the defense, and if the transaction was equivocal, the defendant should have given evidence of facts to show the alleged illegal intent * * *."

If the broker charges a customer only what he paid, can it be said that he has any usurious intent? The language in *Smith v. Heath*³³ is instructive on this point:

"The extra rate of interest charged and paid therefor in no way inured to the benefit of the defendants (brokers)."

The broker does not gain by the high rate, if he charges only what he has to pay. According to *Haughwout v. Garrison*³⁴ the burden would seem to be upon the customer to show that the charge was interest, not expenses—the determination of the question being left to the jury.³⁵

If the loan is from the broker to the customer, the broker may, of course, charge six per cent. interest, even though he only paid four per cent. for the money. But if he does not in fact pay interest in excess of six per cent., he cannot recover from the client more than the six per cent. So, too, where the broker has paid over six per cent. interest, he cannot recover more than he has paid. There would be no justification for charging to the customer as expenses what the broker had not expended.

If such a charge were made, however, and not agreed to by the customer, it is not certain that a recovery would be refused on the ground of usury. In *Morton v. Thurber*,³⁶ the defendant advanced \$67,000 to the plaintiff, charging him with \$68,000 and interest on same. The Referee found that the plaintiff had assented to the allowance of the \$1,000 difference "under the belief that it was an expense incurred by Thurber (defendant) and on his representation that he had to pay that sum to procure" the money advanced. Thurber had never paid the \$1,000 in question. The Court said, per Rapallo, J., at page 556:

³²*Supra.* ³³*Supra*, at p. 126. ³⁴*Supra.*

³⁵*Thurston v. Cornell, supra.* ³⁶(1881) 85 N. Y. 550.

"There was no agreement between the parties which authorized Thurber to charge the plaintiff with the \$1,000 under the circumstances. If he had collected this \$1,000 from the plaintiff, suppressing the fact that he had not paid it, it would have been a clear fraud upon the plaintiff, but would not have constituted usury. To constitute usury, it must be shown that the additional interest is paid or retained in pursuance of a mutual agreement between the parties."³⁷

The determination that no usury existed rested, apparently, upon the fact that there was no agreement authorizing the defendant to charge as expenses what he had not expended. If, however, the plaintiff had agreed to such a charge (there being no such expenditure), the indication is that the transaction would have been usurious. In such a case, the agreement, instead of abrogating the usury, creates it.³⁸

Up to this point, I have assumed that the broker can determine what interest he paid upon the money which he, in turn, loans to the customer, and thus ascertain what amount to charge the customer as expenses on the latter's account. Of course, such expenses are usually not capable of definite ascertainment, since the loans obtained are not specifically applied to any particular customer's account. The broker's method of computation may be distinctive, but the following is, perhaps, a representative method.

The broker averages the daily rates paid by him on all loans after the date of the purchase of the stock. The average rate for the first day may be ten per cent., for the second day twelve per cent., and so forth. At the end of the month the broker averages the daily average and renders an account, charging the customer with the monthly average of interest upon the customer's average monthly debit balance.

It will be seen, then, that the customer may, perhaps, be charged with a higher rate of interest than was actually paid on his loan. On the other hand, the charge may be less. Will not usage justify such rough estimate, if *bona fide*, of the expenses incurred on the customer's account? Will it not, also, supply the authorization necessary to the theory that the extra interest paid is an expense incurred at the customer's request and upon his promise to repay?

The following statement is made in *Harris v. Tunbridge*:³⁹

³⁷*Guggenheimer v. Geiszel* (1880) 81 N. Y. 293. See also *Hagaman v. Reinach* (1905) 48 Misc. 206.

³⁸*Cf. Robinson v. Norris, supra; Hagaman v. Reinach, supra.*

³⁹(1880) 83 N. Y. 92, 100.

"The drift of the evidence is that there is no general rule or custom for operating in stocks, but each dealer acts on his own judgment."

This language, however, probably expresses more than the court intended, or else the evidence in the case must have been decidedly defective. Usages have been recognized in the stock brokerage business of New York City since 1823, at least—the date of the decision in *Nourse v. Prime*.⁴⁰ In that case (page 82) the court said, with regard to the right of a broker to hypothecate a customer's stocks:

"Considering the established usage and practice of brokers in similar cases, and the general and known course and extent of business of the defendants, as dealers in stock, there was an implied authority from the plaintiff to the defendants to sell or pledge the stock to raise money to meet their advances in respect to this very plaintiff."

There can be no question that a usage exists among brokers in this city to charge their customers with a part, at least, of the interest paid in excess of six per cent. Does such usage bind the customer?

In *Esterly v. Cole*⁴¹ the question was whether plaintiffs, who were merchants, could charge any interest on an account for goods sold and delivered. Bronson, C. J., said:

"An agreement for interest may be inferred from the course of dealings between the parties; as where interest has before been charged and allowed under like circumstances. Also where the creditor has a uniform practice of charging interest, which was known to the customer at the time of the dealing. And where there is a general usage in any particular trade or branch of business to charge and allow interest, parties having knowledge of the usage are presumed to contract in reference to it; and if the usage does not conflict with the terms of the contract, it will be deemed to enter into and constitute a part of it. Knowledge of the usage may be established by presumptive, as well as by direct, evidence. It may be presumed * * * from other facts, as the uniformity, long continuance and notoriety of the usage."

Many of the usages of stock brokers purchasing on margin are so well established, according to some old cases, that parties dealing with them are presumed to know and assent to the usages.

⁴⁰(1823) 7 Johns. Ch. 69, 82. ⁴¹*Supra*.

In *Peckham v. Ketchum*⁴² the usage in question was the failure of the broker to disclose the principal's name. The Court said:

"The plaintiff dealt with the defendants as stock brokers and was bound by those customs which prevailed in relation to that species of business."

The correct general rule is probably the one set forth in *Harris v. Tunbridge*.⁴³

"A custom or usage which binds the parties to a contract does so only upon the principle, either that they have knowledge of its existence or that it is so general that they must be supposed to have contracted with reference to it."

It is doubtless true that any customer who has knowledge of the usage under consideration is bound by it, as to transactions where the broker charges no more (above six per cent.) than he has paid. In a case, however, where the customer has been shown to be unfamiliar with Stock Exchange transactions, and therefore has no knowledge, is the usage so general as to be binding? The exact question has never been decided. It would seem, however, that the custom must be sufficiently established, since, as appears by *Robinson v. Norris*,⁴⁴ the brokers in that case, as early as 1872, wrote their customers that it was their practice, in case of stringent money markets, "to charge them (the customers) in proportion to their debit balances, such expenses as we may have to incur by reason of the stringency."

In *Wicks v. Hatch*,⁴⁵ it was held that a power of attorney to transact the business necessary to the purchase and sale of stocks "involved the necessity of employing a broker, for the purpose of buying and selling, the pledge of securities purchased, and the right of the broker to protect himself against losses and risks, according to the usual manner and custom in similar cases."

Assuming, then, that the usage under consideration is sufficiently general, the following restrictions should be borne in mind:

First: The custom must not be transgressed by the broker.⁴⁶

Second: It must not be contrary to any rule of law.⁴⁷ It cannot, for example, be used to cover usury.

⁴²(1859) 5 Bosw. 506. See also *Whitehouse v. Moore* (1861) 13 Abb. Pr. 142.

⁴³*Supra.* ⁴⁴(1874) 51 How. Pr. 442. ⁴⁵(1875) 62 N. Y. 535.

⁴⁶*Newman v. Lee* (1903) 87 App. Div. 116.

⁴⁷*Hopper v. Sage* (1889) 112 N. Y. 530; *Baker v. Drake* (1876) 66 N. Y. 518.

Third: It cannot be used to contravene the property rights which the law declares that the customer has under the contract.⁴⁸ Thus, in the absence of an agreement to the contrary,⁴⁹ custom cannot justify the sale by the broker of the stocks purchased by him on margin, unless he has given notice to the customer and complied with the other requirements necessary to authorize such sale.⁵⁰

The usage in question seems to me to fulfill all these requirements. In regard to the method of computing the expenses incurred by the broker on the customer's account, the following case shows the limits at which the broker must stop.

In *Marye v. Strouse*,⁵¹ the broker sought to justify, on the ground of custom, a charge for the cost of telegrams. It appeared that, at times, the broker would send a message containing orders for several customers, the total cost being perhaps seventy-five cents or thereabouts and each customer being charged seventy-five cents. "No effort was made to keep an account of the sums actually paid out for telegrams about his business." The Court said:

"A custom or usage like this, of charging customers, in addition to commissions, not merely the actual cost of telegrams, but an arbitrary sum, ordinarily much more than actual cost, if it can be considered reasonable, ought to be established by very satisfactory proof, and it should also appear that both parties had knowledge of it."

The Court says, further (at p. 487):

"It being conceded that the charge is excessive, unless supported by custom, the burden of showing what the real cost of the telegrams was is on the plaintiffs (brokers)."

Since the charge to the customer in the transaction herein supposed is often not excessive, the case last cited does not conflict with the rule in certain decisions above cited⁵² that the burden of proving usury is upon the customer.

It should be noted, however, that to justify any charge by the broker against the customer, the broker must have conducted for him some actual transaction. It is not sufficient for the broker

⁴⁸ *Markham v. Jaudon, supra*; *Douglas v. Carpenter* (1897) 17 App. Div. 329.

⁴⁹ *Leiter v. Thomas* (1905) 110 App. Div. 879.

⁵⁰ *Sanger v. Price* (1906) 114 App. Div. 78.

⁵¹ (1880) 5 Fed. 483. ⁵² *Haughwout v. Garrison, supra*.

merely to offset on his books the buying orders of one customer with the selling orders of another.⁵³

It might be well to say, in passing, that the practice of rendering monthly accounts to the customer is not usurious, although it may result in the charging of compound interest, *i. e.*, interest upon the interest shown by the account of the previous month. In *Hatch v. Douglas*,⁵⁴ such a charge was justified on the ground that the customer could pay the interest at the end of the month and thus avoid a compounding of it. The Court, after referring to the usages of New York stock brokers, said (at p. 129) :

"Is a contract usurious which is legal on its face, but which is to be performed according to a local custom, when that custom in one contingency calls for compound interest? We think not. The vice is not certain, it is only possible."

While this is not a New York decision, the reasoning seems to be within the well settled principle stated in *Sumner v. The People*:⁵⁵

"If the payment is conditional, and that condition is within the power of the debtor to perform, so that the creditor may by his debtor's act be deprived of any extra payment, it would not be usurious."

If the customer who objects to the charging against him of the interest paid is one to whom like charges have been made in the past without dispute, is not such customer estopped from objecting?

In *Robinson v. Norris*,⁵⁶ the Court said, by Van Brunt, J. (p. 448) :

"It seems to me that the defendant was in duty bound, if he intended to dispute these charges, to notify the plaintiffs at once, as soon as he was made aware of the fact, and not let them make day by day these expenditures for his benefit, and not wait until he is called upon to pay to dispute them. If he did not desire them to raise money to carry his stocks at such high rates, he should have said so, and then the plaintiffs could have protected themselves."

This language, it seems to me, is directly applicable to cases where charges similar to the one objected to have been made in the past without objection.⁵⁷

⁵³*Haight v. Haight & Freese Co.* (1906) 112 App. Div. 475.

⁵⁴(1880) 48 Conn. 116.

⁵⁵(1864) 29 N. Y. 337, 340. See also *Hart v. Dewey* (1830) 2 Paige 207.

⁵⁶*Supra.* ⁵⁷See, however, *Narden v. Duke* (1908) 120 App. Div. 1.

Even if the charge disputed is the first one which has ever been made to the customer, it is perhaps possible for him to waive his right to object, by not objecting promptly. In *Knickerbocker v. Gould*,⁵⁸ the Court said:

"The defendant was a witness upon the trial and he did not deny that he received the account; and he retained it without making any objection, although the letter in which it was enclosed fairly challenged him to dispute it if inaccurate. He must, therefore, be deemed to have assented to its accuracy, and the plaintiffs, therefore, rightly contend that it became a stated account."

In *Stenton v. Jerome*,⁵⁹ the Court, in connection with a broker's account rendered, described an account stated and then said:

"If one party presents his account to the other and the latter makes no (seasonable) objection, it may well be inferred that he is satisfied with and assents to it as correct. If an account be made up and transmitted by one party to the other by mail, and the latter keeps it for some considerable time without making any objection, he is held to have acquiesced in it.

But, according to *Eames Co. v. Prosser*,⁶⁰ there must be proof in some form of an express or implied assent to the account rendered by one party to another before the latter can be held to be so far concluded that he can impeach it only for fraud or mistake."⁶¹

In conclusion, it may again be noted that, since the use of the money inures primarily to the benefit of the customer, it is but just that the customer should pay what is charged for its use. The equities of the case are, therefore, with the broker, *if he charges only what he paid.*

HAROLD C. MCCOLLOM.

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⁵⁸(1889) 115 N. Y. 533, 537.

⁵⁹*Supra.*

⁶⁰(1898) 157 N. Y. 289.

⁶¹See also *Buch v. Houtaling* (1905) 110 App. Div. 52; but note *Burham v. Lockwood* (1902) 71 App. Div. 301.